Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
Federal-State Joint Board	)	CC Docket No. 96-45
On Universal Service	)	

High-Cost Universal Service Support and the ETC Designation Process

Comments of Beacon Telecommunications Advisors, LLC

Beacon Telecommunications Advisors, LLC (Beacon) submits these comments in response to the Federal-State Joint Board seeking comment on certain of the Commission's rules relating to high-cost universal service support and the ETC designation process.[1] Beacon is a regulatory, financial, and management consulting firm providing services to small, rural, and tribal incumbent local exchange carriers (ILECs) throughout the United States.

Summary of Comments

Many of the questions asked by the Joint Board seemed to be concerned with refining the federal Universal Service Funds (USFs) by requesting information on study areas in which a Competitive Eligible Telecommunications Carrier (CETC) is providing services. The Joint Board also inquired about primary lines with the likely purpose of retargeting and/or reducing the size of the current or future federal USFs. The answer to these questions will be insightful, but there appears to be a basic misunderstanding underlying many of the questions.

[1] FCC Public Notice released 2/7/03

What may not be clear is that the Incumbent Local Exchange Carriers (ILECs) or Eligible Telecommunications Carriers (ETCs) and the Competitive Local Exchange Carriers (CLECs) or CETCs have very different claims on the USFs. While the USFs are intended to be "competitively neutral" and not advantage or disadvantage any particular provider, e.g., ILEC vs. CLEC, the monies received from the federal USFs have a very different basis for ILECs vs. CLECs.

For rate of return ILECs, the federal USFs recover a portion of their legitimate interstate revenue requirements, calculated per FCC rules. The fact that these interstate revenue requirements are recovered in federal USFs does not make them any less recoverable. The FCC has the same obligations to allow the rate of return ILECs to recover these interstate revenue requirements assigned to the federal USFs as it did when there were recovered in interstate access charges.

Assuming that the rate of return ILECs' interstate revenue requirements are legitimate, there is really little that can be done to reduce them, regardless of the distribution method chosen, e.g., primary line, primary plus second line, etc. Other than move some of the interstate revenue requirements back to interstate access rates, the only other area for reduction is the amount paid to the CLEC/CETCs.

One method would be to pay the CLEC/CETCs based on their own actual costs. In order to obtain comparable results with the ILECs, this would require extensive information from the CETCs that would be calculated by the same procedures as those used by the rate of return ILECs. A second method would be to pay the CETCs based on models that would develop either incremental or TELRIC costs for the various CETC types – wireless, CATV and electric utility. The type of model would depend on whether the CETC type is predominately a telecommunications provider or rather if being a telecommunications provider is incremental to their core business.

Comments

Many of the questions asked by the Joint Board seemed to be concerned with refining the federal Universal Service Funds (USFs) by requesting information on study areas in which a Competitive Eligible Telecommunications Carrier (CETC) is providing services. The Joint Board also inquired about primary lines with the likely purpose of retargeting and/or reducing the size of the current or future federal USFs. The answer to these questions will be insightful, but a misunderstanding appears to underlie many of the questions.

What seems to be missing is an understanding that the Incumbent Local Exchange Carriers (ILECs) or Eligible Telecommunications Carriers (ETCs) and the Competitive Local Exchange Carriers (CLECs) or CETCs have very different claims on the USFs. While the USFs are intended to be "competitively neutral" and not advantage or disadvantage any particular provider, e.g., ILEC vs. CLEC, the monies received from the federal USFs have a very different basis for ILECs vs. CLECs.

History of Federal USFs

The reason that this cursory review of history is important is that before anyone knew what an ILEC, CLEC, ETC or CETC was, the costs associated with each of these funds were already included in the interstate revenue requirements of regulated local telephone companies, or what is now referred to as ILECs. Before the costs associated with these USFs were made explicit, all of the costs associated with these federal USFs were at one time recovered "implicitly" through interstate access charges.

Prior to federal price caps, interstate access charges were set based on each ILEC's individual interstate revenue requirements. These interstate revenue requirements were either calculated based on an ILECs specific costs as defined per Federal Communications Commission (FCC) rules contained in Code of Federal Regulations and Regulations Title 47 – Telecommunications, Part 32 (Uniform System of Accounts for

Telecommunications Companies), Part 64 Subpart I (Miscellaneous Rules for Common Carriers – Allocation of Costs), Part 36 (Jurisdictional Separations Procedures: Standard Procedures for Separating Telecommunications Property Costs, Revenues, Expenses, Taxes and Reserves for Telecommunications Companies), Part 65 (Interstate Rate of Return Prescription Procedures and Methodologies) and Part 69 (Access Charges) or were calculated per FCC approved interstate average schedules, depending on whether an ILEC was a cost company or average schedule company.[2]

For rate of return ILECs, their individual interstate revenue requirements are set to recover their legitimate interstate expenses and taxes plus a reasonable return[3]. Interstate investment, expenses, reserves and taxes plus the interstate rate of return level are calculated per rules approved by the FCC and/or the FCC and the National Association of Regulatory Utility Commissioners (NARUC). These rules are designed to allow the ILEC the opportunity to recover their interstate expenses and taxes plus earn a fair return on their interstate net investment.

In implementing the 1996 Telecommunications Act, the FCC, after consultation with the Joint Board, moved costs to explicit federal Universal Service Funds that had been determined via the separations process to be interstate costs. In addition, these interstate costs were included in the interstate revenue requirements[4] that were recovered implicitly in interstate access charges per Part 69. For example, revenue requirements associated with the current High Cost Loop Support (HCLS)[5], Long Term Support (LTS)[6], and Interstate Common Line Support (ICLS) were all part of the Carrier Common Line

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[2] Starting in January 1, 1998, the rules for calculation of LSS and LTS are contained in Part 54 Universal Service.
[3] Arguably this interstate revenue requirement is still a "floor" even for federal price cap ILECs, but for simplicity's sake, this discussion will concentrate on rate of return ILECs.
[4] In general for this discussion, revenue requirements are costs plus a rate of return on net investment. Technically interstate costs, not revenue requirements, are calculated in Part 36. Part 36 does not calculate either an intrastate or an interstate return component. Part 65 contains the interstate return instructions and the results of Parts 36 and 65 are combined in Part 69 to calculate interstate revenue requirements.
[5] For simplicity's sake, this only applies to the HCLS contained in Part 36 Subpart F Universal Service Fund.
[6] Technically LTS is only available to study areas of rate of return ILECs that have been in the NECA Common Line Pool since January 1, 1998.

(CCL) access element while the revenue requirements associated with Local Switching Support (LSS) were a part of the Local Switching access element.

The changes to Part 69 and the introduction of Part 54 that moved these interstate revenue requirements from implicit charges to explicit "USF" charges did not change the fact that all of these "USF" costs are interstate revenue requirements. The point is that for rate of return ILECs, the costs associated with all of the current federal USFs were a part of their legitimate interstate revenue requirements before being moved to these USFs and these costs are still a part of their legitimate interstate revenue requirement today. For rate of return ILECs, these funds are not gifts but instead are a part of the total payment for their provisioning of interstate services. If these legitimate revenue requirements are not recovered through the federal USFs that they have been assigned to by the FCC, they must be recovered from some other interstate revenue source.

This is important if the FCC, after consultation with the Joint Board, decides to limit the size of the USFs to a point such that the rate of return ILECs are not allowed to completely recover their interstate revenue requirements. Under today's rules, any such under-recovery from the USFs will not automatically cause another interstate mechanism to automatically recover the difference between the now realized interstate revenue and the actual interstate revenue requirement. However, assuming that these are legitimate interstate revenue requirements calculated correctly per FCC rules, the FCC may find itself in the position of acknowledging the costs as interstate, but not allowing the rate of return ILEC an opportunity to recover them from interstate services. Generally, once revenue requirements have been recognized as belonging to a particular jurisdiction, and the revenue requirements are legitimate, the services in that jurisdiction as a whole will be set so as to recover the total jurisdictional revenue requirement.

Simply stated, if the FCC decides to limit the amount a rate of return ILEC receives from federal USFs, the FCC should consider coupling such a limiting action with the increase of another interstate rate to offset the reduction in the payments made by federal USFs in recovering the legitimate interstate revenue requirements of rate of return ILECs.

Per convention there are only a limited number of ways to decrease interstate revenue requirements. One way is to perform an audit of Part 32 results and find that the individual ILEC is not following the rules. A second way to decrease interstate revenue requirements is to investigate Part 64 results and find that the individual ILEC's Cost Allocation Manual (CAM) is either not in keeping with FCC rules or not being implemented per its CAM. A third way is to reallocate the interstate costs to the state jurisdiction. This could not be done unilaterally by the FCC and would require action by a separations Federal/State Joint Board.

A fourth way to decrease interstate revenue requirements is to disallow the interstate costs of an individual ILEC by finding that these particular costs are not legitimate. A tempting variation of this option is if the FCC, after consultation with the Joint Board, limited the interstate allocation of a certain account, similar to the Corporate Operations Expenses limitation per section 36.621(a)(4). The difference between limiting the expense used in the calculation of the High Loop Cost Expense Adjustment of the High Cost Loop Support and limiting an interstate expense used in the calculation of interstate revenue requirements is that in the former case, the amount above the limit remains in the intrastate jurisdiction for recovery there. This happens because this portion of High Cost Loop Support is an additional allocation from the intrastate jurisdiction to the interstate jurisdiction. So any cost not "additionally allocated" by the high cost formula remains in the intrastate jurisdiction. In the latter case the costs have already been allocated to the interstate jurisdiction, so if the FCC limits an expense that has already been allocated to the interstate jurisdiction it would amount to a disallowance. On the other hand, if the FCC could convince the Federal/State separations Joint Board to change the Part 36 separations rules to incorporate such a limit to the interstate jurisdiction, there would be no disallowance since the above-limit expenses would then be allocated to the intrastate jurisdiction and intrastate costs are frequently calculated as a residual in Part 36.

A fifth way to decrease interstate revenue requirements is to lower the interstate rate of return. The first, second and fourth options require the FCC to look at individual ILEC data before making a determination. There are a large number of rate of return ILECs, so without a significant increase in staffing, this may not be practical. The third option requires action by a separations Federal/State Joint Board. Based on recent history, however, the separations Joint Board does not act quickly. The fifth option - lowering the interstate rate of return - is something that the FCC can do on its own, but quick action may be unlikely.

CLEC/CETCs

CLEC/CETCs currently have not made a revenue requirement claim on the FCC to recover their interstate costs, if for no other reason than the fact that they are not rate of return regulated. Therefore, the USF amounts that the CLEC/CETCs receive are not necessary to recover interstate revenue requirements. This is not to imply that CLEC/CETCs do not have costs associated with the provision of supported services, only that these costs do not have the same legal standing as the interstate revenue requirements of the rate of return ILECs.

The federal USFs have been designed to do two things: 1) they pay the ILECs a portion of their legitimate interstate revenue requirements as calculated per the FCC's rules and 2) they have also been designed to be competitively neutral for the CLEC/CETCs. Based on recommendations of the Joint Board, the FCC has implemented this by paying the CLEC/CETCs the same amount that the ILEC receives, providing the CLEC/CETC serves the same ILEC study area[7]. One of the underlying concerns of this NOI appears to be that with intended participation of CETCs in the USFs and where the level of the USFs are not capped, the funds may grow too large.

Based on the previous discussion, the USFs can be no smaller than the interstate revenue requirements that the FCC reallocated from interstate access charges to the federal USFs.

[7] Technically the CLEC/CETC receives the same amount as the ILEC based on the disaggregation option chosen by the ILEC within the study area. For simplicity's sake, disaggregation will be ignored.

These revenue requirements are calculated by the rate of return ILEC without regard to primary line, secondary line, lost line, etc. They are based on the actual incurred costs of the ILEC. So even if the FCC decides to only allow one ETC/CETC to receive USF for a given customer, if the ILEC has continuing costs associated with the customer, e.g., "stranded" investment, the ILEC still has a revenue requirement associated with that "lost" customer.

While in the past, it may have been argued that the separations process may have reallocated those stranded costs, due to any changes in the relative interstate usage, that argument cannot be made today given that separations factors have been frozen. Therefore if the ILEC is not the provider for USF purposes, the interstate and intrastate costs will likely still stay the same, regardless of the change in actual relative usage patterns.[8] The same thing would be true if the FCC decided after consultation with the Joint Board that only a primary line should be used as the payment vehicle. If the ILEC no longer received compensation from the USF, the revenue requirement would still remain in the interstate jurisdiction and would need to be recovered from another interstate revenue source.

If the Joint Board wanted to recommend to the FCC that the USFs should be reduced, how could this be done? If the Joint Board wants to start with the rate of return ILECs/ETCs, then it has to recommend that the FCC reduce the interstate revenue requirements of the rate of return ILECs assigned to the USFs. In addition to the five ways discussed above, which are not quick processes, the only expeditious method would be for the FCC to move some of the USF costs back to interstate access rates[9]. This would appear to be a departure from the way both the Joint Board and the FCC have

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[8] It is doubtful that there would be any significant changes in total costs. Gross and net investment will be almost entirely unchanged. The only exceptions might be in motor vehicles or office space, but these are generally small accounts. Expenses might be lowered if employee count is reduced. However, in small ILECs, where it is not uncommon that there is only one or part of one employee doing particular tasks that could be reduced, it is difficult to reduce a fraction of one employee.
[9] Since interstate Subscriber Line Charges (SLCs) are currently capped, interstate access rates are the only interstate services whose rates are not capped. However, in theory, for a rate of return ILEC where SLCs are lower than the caps, the FCC could adjust the costs associated with SLCs up to the capped level.

interpreted the 1996 Communications Act. In short, because these costs of the rate of return ILECs are legitimate interstate revenue requirements, they cannot be made to disappear easily.

This leaves the other group of receivers at issue – the CLECs/CETCs. Today they receive the same payments as the ILEC/ETC serving the same study area. In addition, these payments are not limited to only one CETC per study area. Arguably there could be three CETC types serving the same study area - wireless, CATV and electric utility.

The recent request of Alltel for CETC status for their wireless company shows that it is possible for an ILEC/ETC to have a CETC in the same study area and therefore the holding company would receive double USF payments for each of the CETC's customers receiving supported services in their ILEC/ETC's study area. It is also possible that an ILEC/ETC could have affiliated companies that own all three CETC types – wireless, CATV, and electric utility, rather than, as in the case of Alltel, only one CETC type - wireless. It is also possible that at least two of the CETC types – CATV and electric utility could be using the same physical facility as the ILEC/ETC, e.g., different individual fibers in the loop cable. In this example, the same company could be receiving up to 4 times the amount of USF if an individual customer had qualifying service from each CETC, than it would have if it only provided supported telecommunications services through its ILEC affiliate. This is an extreme case, but it highlights the problem.

Possible Approaches to Limiting the Size of the USFs

One way to approach this problem would be to have all CETCs receive their USF payments based on their actual costs rather than the ILECs USF payment that is based on the rate of return ILECs' interstate revenue requirements. For comparability purposes, a common accounting system and categorization/allocation[10] system would be ideal. For

[10] For rate of return ILECs, this categorization and allocation step is done in Part 36. It is here where loop and local switch is defined from Part 32 accounts that do not contain these distinctions. In addition, the

the sake of simplicity the interstate rate of return could be used, although it might not be appropriate for non-ILECs. This would allow at least some comparisons across all USF receivers. Arguably this would require the FCC to mandate such an accounting and categorization system on entities that heretofore have not been regulated in this manner by the FCC.

Another approach would be to use a model of the costs of each of the CETC types mentioned above, i.e., wireless, CATV and electric utility. The reasons for modeling are the same already adopted by the FCC in its use of the TELRIC model. In addition, as discussed above, the FCC does not have any revenue requirement responsibility for the CETCs so there is no concern that the modeled costs will not allow for sufficient recovery of actual revenue requirements.

Different types of modeling may need to be employed based on whether the CETC type will provide supported services using "stand alone" architecture or architecture integrated with their core business. For CETCs that are not predominately telecommunications providers and have economies of scope as a result of their predominant business that will allow them to leverage their existing facilities to provide supported services, a model that reflects their incremental costs of providing telecommunications services may be more appropriate. Examples of this type of CETC would include CATV and electric utility.

On the other hand, for CETCs that are predominately telecommunications providers and therefore the supported services are not "incremental" services, a TELRIC model of their costs per their technology may be more appropriate, rather than an incremental model. Wireless would be an example of this type of CETC.

Therefore a wireless CETC would receive its USF based on the results of the wireless TELRIC model; a CATV CETC would receive its USF based on the results of the CATV

same allocation of related and general costs to categories could be done via a Part 36 or part 69 methodology.

incremental model; and the electric utility would receive its USF on the electric utility incremental model.

This approach would not be easy or quick to implement. However, under the right conditions, it could be done: 1) if rate of return ILECs are entitled to recover their interstate revenue requirements (even those included in federal USFs) and if Federal USFs are deemed to be competitively neutral because they pay all CETCs serving an ILEC/ETC study area on the same basis as the ILEC/ETC; 2) if the current USFs continue to be designed to recover "subsidies" which should not be recovered in interstate access rates;[11] and 3) if there is the concern that the federal USFs will become "too large", then this approach may be a reasonable alternative to consider.

Conclusion

Beacon appreciates the Joint Board's difficult task of devising a workable solution for the sustainability of the universal service support fund. Beacon is committed to assisting the Joint Board in this venture that will help preserve the universal service fund while promoting competition in the spirit of the Act.

Respectfully submitted,

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[Filed Electronically]

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[11] It would seem reasonable that if there were effective local competition, it would not be necessary to move "subsidies" out of interstate access rates. In fact if there were effective local competition, it would seem reasonable that any local provider would want to make sure that it charges any customer that receives benefit from the use of their facilities. No competitive market only charges the "cost causer". The competitive market charges those that receive benefit a commensurate rate, regardless if they are THE cost causers or not. Charging only the "cost causer" is a relic of the early 1980's when there was only emerging interexchange competition and no hint of local competition. Continuation of this relic acknowledges that effective local competition is no closer than it was 20 years ago. So in one sense it could be argued continuing to remove the "subsidies" from interstate access rates acknowledges no change in the competitive landscape as a result of the Telecommunications Act of 1996.